

U.S. Issues New Sanctions Authorities Following Implementation of China's National Security Law for Hong Kong

July 21, 2020

On July 14, 2020, President Trump announced new U.S. sanctions authorities related to the Hong Kong Special Administrative Region (“Hong Kong”) of the People’s Republic of China (“PRC” or “China”). No sanctions have yet been adopted under the new authorities but, nonetheless, the actions mark a significant escalation in the United States’ response to changing circumstances in Hong Kong.

This step occurs against the backdrop of increased trade compliance measures targeting China over the previous year, including 3 tranches of U.S. export restrictions by the U.S. Commerce Department’s Bureau of Industry and Security (“BIS”) against Chinese technology and manufacturing companies “implicated in human rights violations and abuses” in the Xinjiang Uyghur Autonomous Region (the “XUAR”) of China), a new rule effective next month prohibiting U.S. government contractors from using certain Chinese equipment or services (even if unrelated to the services performed for the government) and an expansion of U.S. export controls targeting “military end use” and “military end users” in China to address U.S. authorities’ concerns about China’s “military-civil fusion” program.¹

Why Is the United States Adopting New Sanctions Related to Hong Kong?

U.S. leaders, including Congress, President Trump and the Secretary of State, have expressed concern that new security measures for Hong Kong adopted by the PRC violate commitments regarding Hong Kong’s political and judicial autonomy from China, including commitments made in 1997 when the United Kingdom returned sovereignty over Hong Kong to the PRC.

In particular, the *Law of the People's Republic of China on Safeguarding National Security in the Hong Kong Special Administrative Region* (the “National Security Law” or “NSL”) now criminalizes a range of conduct that U.S. authorities state could potentially restrict liberties previously enjoyed by residents of Hong Kong and authorizes new police

¹ See Appendix A for a timeline of select recent events reflecting the increasingly strained U.S.-China relationship.

powers in the region, some of which, according to U.S. authorities, appear inconsistent with Hong Kong's historical practices.

What Are the New Hong Kong-Related Sanctions?

There are two new sanctions authorities—the Hong Kong Autonomy Act (the “HKAA”) and new Executive Order 13936 of July 14, 2020. As noted, no sanctions have yet been adopted under either authority.

HKAA. The HKAA authorizes (1) blocking sanctions against foreign individuals, entities or organizations that “materially contribute” to China’s failure to preserve Hong Kong’s autonomy and (2) menu-based sanctions, including blocking sanctions, against foreign financial institutions that “knowingly conduct significant transactions” with such identified persons.²

Within 90 days of the HKAA’s adoption (October 12, 2020), the Secretary of State is required to report to the U.S. Congress whether any person meets the first criteria, subject to certain exclusions. Between 30 and 60 days later, the Treasury Secretary must identify any foreign financial institutions that meet the second criteria, again subject to certain exclusions. Additionally, even if a person or foreign financial institution is so identified, the President may waive, for national security purposes, application of otherwise mandatory sanctions.

E.O. 13936. The new Executive Order authorizes blocking sanctions for a wider range of conduct, including against persons determined to have been involved in the following activities:

- The development, implementation or enforcement of the NSL;
- Actions or policies that “undermine democratic processes or institutions in Hong Kong” or “threaten the peace, security, stability, or autonomy of Hong Kong”;
- Censorship or other activities that restrict the freedom of expression, assembly and the press in Hong Kong; or
- Gross violations of internationally recognized human rights or serious human rights abuses in Hong Kong.

² Please see our earlier [client update](#) for further discussion of the Hong Kong Autonomy Act.

The Executive Order also authorizes blocking sanctions against certain related persons, including:

- Persons who provide “material assistance” to any such identified persons;
- Any current or former leaders or officials of entities, including governmental entities, found to have engaged in certain of the activities described above; and
- Any board director or senior executive officer of an entity that becomes blocked under the Executive Order.

Has the U.S. Government Used This Authority to Impose Sanctions?

Not as of this writing. As noted, the HKAA and new Executive Order merely authorize, but do not impose, new sanctions related to Hong Kong. Persons targeted for sanctions under the HKAA may first be identified in a report to Congress (sanctions are authorized “on or after” the date of identification in the report, with sanctions becoming mandatory within one year of identification), but there is no similar notification requirement for sanctions imposed under E.O. 13936, and sanctions may be imposed under that authority without prior notice.

Although there have been no designations under either authority to date, recent actions in a similar context, namely statutory sanctions reflecting the U.S. Congress’s concerns about human rights in the XUAR, demonstrate the wide discretion available to U.S. authorities in exercising these and related sanctions authorities. Adopted the preceding month (June 2020), the *Uyghur Human Rights Policy Act of 2020* authorizes sanctions against those deemed responsible for human rights violations in the XUAR. However, when adopting recent sanctions against Chinese officials “in connection with serious rights abuses against ethnic minorities” in the XUAR, the Trump administration did not rely on this new authority but, rather, adopted the sanctions under the existing Global Magnitsky Sanctions program of the U.S. Treasury Department’s Office of Foreign Assets Control (“OFAC”).

How Does This Relate to the Revocation of Hong Kong’s Preferential Treatment under U.S. Law?

As discussed in our earlier [client update](#), the Hong Kong Policy Act of 1992 recognized Hong Kong as distinct from China for purposes of U.S. law but allows the U.S. President

to revoke that recognition if the President “determines that Hong Kong is not sufficiently autonomous to justify treatment under a particular law of the United States, or any provision thereof, different from that accorded” to China.

E.O. 13936 declares that “the policy of the United States [is] to suspend or eliminate different and preferential treatment for Hong Kong to the extent permitted by law and in the national security, foreign policy, and economic interest of the United States.”

To effect that policy, the Executive Order immediately “suspends” preferential treatment for Hong Kong under several statutes and further directs that, by July 29, 2020, the heads of agencies “shall commence all appropriate actions” to implement that suspension. The order describes several such actions, including “eliminat[ing] the preference for Hong Kong passport holders as compared to PRC passport holders” and “revok[ing] license exceptions for exports to Hong Kong, reexports to Hong Kong, and transfers (in-country) within Hong Kong of items subject to the Export Administration Regulations.”

Who Would Face Obligations to Comply with Any New Sanctions?

As in most other U.S. sanctions programs, only “U.S. persons” face compliance obligations with any sanctions adopted under the HKAA or E.O. 13936. For this purpose, a U.S. company’s local branch or office would face direct compliance obligations with the new sanctions.

Approximately 10 U.S. financial institutions maintain branches in Hong Kong. Should sanctions be imposed under the HKAA or E.O. 13936, the attendant compliance obligations could be significant for these branches, especially to the extent they hold accounts for—or offer services to—targeted persons.

Although non-U.S. companies would not face obligations to comply with any blocking sanctions adopted under these authorities, they may face a risk of becoming designated if they engage in meaningful business with a sanctioned entity or individual. Foreign financial institutions that engage in “significant transactions” with a person sanctioned under the HKAA or persons that provide “material assistance” to a person designated under E.O. 13936 may become subject to sanctions by the United States.

Does China Have a Blocking Statute?

Article 29 of the National Security Law criminalizes compliance with “instructions” from a foreign country, institution, organization or individual to impose sanctions against Hong Kong or China. Article 38 extends this offense extraterritorially to persons that are not Hong Kong permanent residents and to actions committed outside Hong Kong.

It remains to be seen how broadly China will interpret and apply these provisions. Many institutions, and personnel working within them, are hoping to avoid a difficult choice: comply with U.S. sanctions or risk penalties (including, potentially, criminal liability) under China’s law.

If No Sanctions Are Adopted under These Authorities, Do U.S. and Other Companies Face No New Obligations?

Even in the absence of new blocking or other sanctions under these authorities, the suspension of preferential treatment for Hong Kong and existence of new sanctions authorities likely will impact U.S. and other companies doing business with or in Hong Kong, particularly by raising compliance-related costs for business conducted in, or with counterparties in, Hong Kong.

For a number of reasons, many U.S. companies’ risk-based sanctions compliance programs consider China to be a medium to high risk country from a U.S. sanctions compliance perspective. Historically, however, Hong Kong has been treated differently, often as a low risk jurisdiction, and impacted U.S. companies will now need to and consider whether their relevant risk assessments are appropriate and whether internal controls require review and updating.

In addition, to minimize the risk of doing business with those persons who most likely may be the target of new sanctions, some financial institutions already are reviewing their local operations and customers to ascertain their level of exposure to potential sanctions targets.

Are There Likely to Be Additional Developments in this Space?

Yes. The Trump Administration is articulating an increasingly hostile stance towards China. In recent weeks, for example, U.S. Secretary of State Pompeo noted that “it is no

longer the case that it's going to be acceptable that the United States is simply going to allow the important commercial relationships that we have between our two countries to put the American people at risk," and an inter-departmental "business advisory" cautioned about the "reputational, economic, and legal risks of involvement with entities that engage in human rights abuses" in the XUAR. More dramatically, U.S. Attorney General Barr recently described the Chinese Communist Party as "seek[ing] to leverage the immense power, productivity, and ingenuity of the Chinese people to overthrow the rule-based international system and to make the world safe for dictatorship."

In this environment, we recommend following developments closely and preparing for further trade sanctions and controls between the United States and China.

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Appendix A

Recent Sanctions and Export Control Developments in U.S.-China Relations

April 28, 2020—BIS expanded restrictions on exports, reexports and transfers under the Export Administration Regulations regarding “military end use” and “military end users” in China (effective June 29, 2020).

May 15, 2020—BIS expanded restrictions under U.S. export controls against Huawei to include certain foreign-made items.

May 22, 2020—BIS added 33 Chinese entities to the Entity List, either for representing a significant risk of supporting procurement of items for military end use in China or for complicity in human rights violations and abuses committed in China’s XUAR.

May 27, 2020—U.S. Secretary of State Pompeo informed Congress that “Hong Kong does not continue to warrant treatment under United States laws in the same manner as U.S. laws were applied to Hong Kong before July 1997.”

May 28, 2020—China’s National People’s Congress approved the NSL for Hong Kong.

May 29, 2020—As a result of the introduction of the NSL, and other perceived challenges by China to Hong Kong’s autonomy, President Trump announced that the United States would begin eliminating policy exemptions that give Hong Kong “different and special treatment” under U.S. law.

The White House further announced new restrictions to prohibit entry to the United States to Chinese graduate students determined to further a “military-civil fusion strategy” designed “to bolster the modernization and capability” of China’s military and called on the Secretaries of State and Homeland Security to propose further measures “that would mitigate the risk posed by the PRC’s acquisition of sensitive United States technologies and intellectual property.”

June 5, 2020—The U.S. Commerce Department’s Bureau of Industry and Security (“BIS”) added nine additional Chinese entities to the Entity List for being “complicit in human rights violations and abuses” in the XUAR (restrictions first announced on May 22, 2020).

June 17, 2020—The United States enacted the “Uyghur Human Rights Policy Act of 2020,” authorizing sanctions against those deemed responsible for human rights violations in the XUAR.

July 1, 2020—U.S. authorities warned of risks for businesses whose supply chains include entities in the XUAR engaged in forced labor and other human rights abuses.

June 30, 2020—China implemented the NSL for Hong Kong. The U.S. State and Commerce Departments responded by announcing the “suspension” of regulations affording preferential treatment to Hong Kong, including with respect to exports of U.S. defense and dual-use technologies to Hong Kong.

July 9, 2020—The U.S. Treasury Department’s Office of Foreign Assets Control sanctioned four current and former Chinese officials and the Xinjiang Public Security Bureau under the Global Magnitsky Sanctions Program, which authorizes sanctions against persons responsible for human rights abuses.

July 13, 2020—China’s Foreign Ministry announced “corresponding sanctions” against U.S. officials, including Senators Ted Cruz and Marco Rubio, and the U.S. Congressional-Executive Commission on China.

July 13, 2020—The U.S. State Department issued a statement indicating the U.S. position of rejecting China’s maritime claims in the South China Sea.

July 14, 2020—President Trump signed the Hong Kong Autonomy Act into law and issued Executive Order 13936.

Federal agencies issued an interim rule amending the Federal Acquisition Regulations to give effect to Part B of Section 889 of *John S. McCain National Defense Authorization Act for FY 2019*, prohibiting U.S. government contractors from using certain Chinese equipment or services, potentially even if unrelated to the services provided to the government (effective August 13, 2020).

July 15, 2020—China’s Foreign Ministry threatened further corresponding sanctions against U.S. officials and institutions related to the passage of the Hong Kong Autonomy Act.

July 20, 2020—BIS added an additional 11 companies to the Entity List for being “implicated in human rights violations and abuses” in the XUAR, and the U.S. Department of Justice charged a Chinese graduate researcher at Stanford University with criminal visa fraud, alleging she concealed her current employment by China’s military.

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Please do not hesitate to contact us with any questions.

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